

Compounding of Contraventions under FEMA

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**Naresh Ajwani
Chartered Accountant**

FEMA – complex law

- FEMA is a policy law. It is not drafted in exact legal language.
- There are several differences between interpretation and practice.
- RBI views have kept changing.
- This leads to several innocent violations.
- The difficulty is compounded by a system with no quick and effective appeal mechanism.
- Some violations are of course due to aggressive interpretation.

Contravention – stages of adjudication

- Investigation. (Section 37)
- Adjudication and levy of penalty. (Section 13)
- **Seizure of assets and prosecution in case of foreign assets. (Sections 13(1A) and 37A)**
- Appeal to Special Director (Appeals). (Section 17)
- Appeal to Appellate Tribunal. (Section 19)
- Appeal to High Court. (Section 35)
- Appeal to Supreme Court.

- Compounding. (Section 15)

Contravention – some hopeful responses

- Let us forget it. Who will come to know.
- Reverse the transaction – and hope that no one will come to know.
- I will gift my foreign assets to my non-resident relative / or in a Trust.

Actions against Black Money

- Exchange of Information is taking place.
- Activist journalism.
- Black Money Law.
- FEMA – seizure of assets and prosecution for illegal foreign assets.
- Benami Law.
- Others ...

Compounding

- Compounding was introduced in FEMA (2000).

FERA:

- Prior to FEMA, there was no Compounding under exchange control law.
- RBI could give post facto approval, but not compound.
- Adjudication could be done by DOE.

Penal consequences for contravention

- If amount is quantifiable, penalty can be upto 3 times the amount involved.
- If amount is not quantifiable, penalty can be upto Rs. 2 lakhs.
- Continuing offence – penalty upto Rs. 5,000 per day.
- Property can be confiscated.

[Section 13]

Penal consequences for contravention

- For violations of Indian assets (i.e. by Non-residents), there is no imprisonment (unless penalty is not paid).
- There is no presumption of “mens rea” (guilty mind).

Seizure and Prosecution

- If foreign exchange, foreign security or immovable property, situated outside India – is suspected to have been has been acquired in violation of FEMA, and the officer has reason to believe it, equivalent Indian assets can be seized. [S. 13(1A)].
- For the above offence, there can be prosecution. [S. 37A].
- No Compounding is available once S. 37A is applied.
- These provisions are applicable if the value of assets is in excess of Rs. 1 cr.

Compounding - meaning

- Compound means to admit a violation and pay up the penalty.
- It is a quick settlement system. One does not have to go through the legal process of adjudication, appeal, etc.

- FEMA violation is not a scheduled offence under PMLA.

Benefits of Compounding

- Simplified process.
- Quick completion of process.
- Multiple / Related offences can be compounded under one application.
- Fastest way to clean the past.
- Once over, there is no “pending investigation”.
- After compounding, no further proceeding can be initiated or continued.

Compounding law

- Section 15 of FEMA provides for compounding of contraventions.
- Compounding Proceedings Rules notified by Central Government from 3rd May, 2000.

Compounding law

- Compounding rules were amended with effect from 13.09.2004.

RBI issued A.P. Circular No. 31 dated 1.2.2005.

RBI has powers to compound all contraventions – except those of S.3(a).

Compounding law

- ED can compound contravention u/s. 3(a) only. [Deal in or transfer any foreign exchange or foreign security to any person other than Authorised Dealers – Hawala transactions.]
- From 2005, compounding process started in true sense.
- RBI was empowered to provide comfort to people to minimise transaction cost.

Key features of Compounding

- It is a **voluntary process** – unlike adjudication where a person can be charged with an offence.
- Person has to **admit the offence**.
- Not a forum for arguing your case.
- Compounding possible only if amount involved is quantifiable.

Powers with Regional Offices of RBI

- Delay in reporting inward remittance in case of FDI.
- Delay in filing Form FC-GPR after allotment of shares.
- Delay in issue of shares beyond 180 days of receipt of funds.
- Mode of receipt of funds.

Powers with Regional Offices of RBI

- Violation of pricing guidelines for issue of shares.
- Issue of ineligible instruments – optionally convertible debentures, etc.
- Issue of shares without FIPB approval.
- Transfer of shares from resident to non-resident and vice-versa; and transfer of shares in the investee company's record.

Powers with Regional Offices of RBI

- Delay in filing FLA returns by companies which have received Foreign Direct Investment.

Powers with Delhi office of RBI

- Immovable property abroad by residents.
- Immovable property in India by non-residents.
- Establishment of Branch, Liaison or Project office.
- Contravention of Deposit regulations (FCNR / NRE / NRO and other non-resident accounts and deposits from non-resident by Indian entities)

Before the Compounding

- **Administrative procedure** should be completed before compounding can be done.
- **Set right** the contraventions before compounding.
- If transactions can't be set right, compounding may not be done.
- If administrative process is not complete, within 180 days of compounding application, application is returned with the application fee.

Administrative procedure

- File forms where they have not been filed.
- Obtain RBI approval if not obtained.
- Obtain FIPB approval for FDI not covered under automatic route.

Administrative procedure

- RBI can decide whether an offence is:
 - technical/ minor and only administrative procedure / cautionary advice is required.
 - material and requires compounding.
 - serious to be referred to Enforcement Directorate.
- If application is filed suo moto, compounding has to be done. Offence cannot be considered technical / minor.

Setting right - means what

- Setting right - may involve - reversing the transaction; unwinding investments.
- Investment under LRS - unwind; or transfer shares to Indian company (except if it is under notification no. 263 dated 5.3.2013).
- ECB - repay the loan/ convert into equity.

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- There cannot be a situation, where - the incorrect transaction continues, & it is compounded.

Compounding application

- Responsibility is normally on the Indian resident – as investee (for FDI), as borrower (ECB), as investor (JV/ WOS abroad).
- Non-Resident is responsible for liaison office, branch, etc. in India.

Compounding application

- Application can be filed:
 - suo moto, or
 - on advice of RBI.
- Advisable to file once RBI advises.

Procedure in brief

- File application form with full details.
- State clearly:
 - Nature of violation.
 - Specific section, rule, regulation.
 - Date from which violation has occurred (to determine the **period of violation**).
 - **Amount involved.**

Procedure in brief

- Specific list of requirements have been prescribed for – FDI, ECB, ODI & Liaison / branch office.
- Undertaking to be given that there is no **pending investigation**.
- Attach Demand draft of Rs. 5,000/- for application fee.

Pending investigation

- If investigation is pending against applicant, group company, promoter, etc. state it.
- RBI will write to ED asking if they have any objection.
- If ED gives NOC, RBI will compound.

Post filing of application

- RBI will ask queries if any.
- Opportunity of hearing is given. Applicant need not appear. If appearance is to be made, direct appearance of applicant is preferred.
- Opportunity to add more violations if one comes across the same.
- Compounding order within 180 days.

Compounding order

- Compounding order is issued based on the merits of the case. It takes into account:
 - period of violation.
 - amount involved.
 - amount of gain wherever quantifiable.
 - loss caused to exchequer.
 - contravener's conduct.
 - etc.

Compounding order

- Compounding sum is determined and stated in the order.

It has to be paid within 15 days from the date of compounding order.

- If the compounding sum is not paid within 15 days, it will be considered that application was never made. RBI may refer the matter to ED.

Compounding order - some issues

- No appeal against Compounding Order (CO) is possible.
- No review of CO.
- No withdrawal of CO.
- No rectification of CO.

Effect of Compounding

- There does not remain a violation of the matter compounded.
- Any violation of the same kind within 3 years of the Compounding, cannot be compounded.
- Automatic route would become open to the person concerned.

Thank you.
Questions and comments are welcome.

Naresh Ajwani
Chartered Accountant